

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. **77-1534**

SOUTH CENTRAL BELL TELEPHONE COMPANY,
Petitioner,

v.

LOUISIANA PUBLIC SERVICE COMMISSION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF LOUISIANA

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**PETITION FOR A WRIT OF CERTIORARI TO THE
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Petitioner, South Central Bell Telephone Company, respectfully prays that a writ of certiorari issue to review the judgment of the Supreme Court of Louisiana entered in this proceeding on February 24, 1978, refusing further consideration of the Court's opinion of November 3, 1977.

OPINION BELOW

The final judgment denying further consideration by the Supreme Court of Louisiana, not yet reported, appears as Appendix at 1a. The Court's earlier opinion, dated November 3, 1977, is reported as *South Central Bell Telephone Company v. Louisiana Public Service Commission*, 352 So.2d 964 (La.1977). Appendix at 3a.

JURISDICTION

The Court has jurisdiction under 28 U.S.C. § 1257(3). The due process requirements of the 14th and 5th Amendments to the Constitution of the United States were raised by petitioner at every state court level. The highest state court, however, affirmed the respondent commission's action without discussing the federal constitutional issues. The fact that these issues were raised is confirmed by the dissenting statement from the grant of a stay to the petitioner. The stay order and the dissent are attached as Appendix at 83a-85a.

QUESTION PRESENTED

Petitioner, a public utility, was collecting revenue under a state district court order reversing, in part, an order of respondent Louisiana Public Service Commission. The district court order itself was subsequently reversed, in part, by the Supreme Court of Louisiana which remanded the matter to the commission for further proceedings. Although the revenue collected was insufficient to yield the rate of return found by the commission and the courts to be just and reasonable, respondent ordered petitioner to refund part of the revenue as excessive. In doing so, respondent, and the Supreme Court of Louisiana by affirming respondent's action, failed to follow *West Ohio Gas Co. v. Public Utility Commission of Ohio* (No. 2), 294 U.S. 79 (1935). The question presented is:

Whether, consistent with the due process requirements of the 14th and 5th Amendments to the Constitution of the United States, a state regulatory agency, in fixing rates for a past period, may order a public utility to make refunds based

on estimates of operating results for that past period while refusing to consider actual results which show the estimates to be incorrect.

CONSTITUTIONAL PROVISIONS INVOLVED

The due process clauses of the 14th and 5th Amendments to the Constitution of the United States are involved in this proceeding.

STATEMENT OF THE CASE

Petitioner, a Delaware corporation, is one of 23 telephone companies providing service in Louisiana. It also provides telephone service in the States of Alabama, Kentucky, Mississippi and Tennessee. Petitioner's intrastate operations are regulated by public service commissions in each of the aforesaid states. Its interstate operations are regulated by the Federal Communications Commission.

On April 18, 1975, petitioner applied for an increase in its Louisiana intrastate rates to the Louisiana Public Service Commission ("commission"). On June 15, 1976, the commission denied the application in its entirety. In doing so the commission elected to use 1975 historical data in setting rates for the future. No consideration was given to rising expense levels and higher construction costs due to inflation and attrition.¹

¹"Attrition" is an erosion in a utility's earnings that results when its investment, operating expenses, or both increase more rapidly than its revenues. The result of attrition is that the rate of return realized in the future will be below that which the rates were designed to produce. Attrition is apt to occur in a period of inflation when comparatively high construction costs result in new facilities being added at above average

(continued)

Petitioner appealed to the Louisiana district court which reversed the commission, in part, upon a finding that "the failure of the commission to consider a substantial adjustment for attrition . . . ignores the realities of economics and in the opinion of this court, is clearly unjustified and unreasonable." Appendix at 87a. On January 6, 1977, the district court remanded the case to the commission for further proceedings to be completed within 45 days. Petitioner promptly filed its most recent actual 1976 operating results with the commission and requested that they be used in calculating the appropriate revenue needed to offset the effects of inflation and attrition.

The commission concluded that it did not have time to analyze the data underlying the actual results and found that, in any event, such an examination "is unnecessary to the computation of an attrition allowance." Appendix at 98a. Instead, the commission in early 1977 had its retained consultant conduct an *ex parte* examination of certain historical data and develop an estimate of the impact of inflation and attrition in 1976, as if 1976 were still in the future.

The commission reported to the district court that, based on its calculation, attrition in 1976 was \$6,714,000 which,

however, it refused to implement without further order of the court. No hearing was held to permit cross-examination and rebuttal of the predictions, selections and assumptions of the commission's consultant. In fact, petitioner had no notice whatsoever that this *ex parte* examination was taking place until the commission's findings were issued.

Petitioner's actual 1976 operating results showed that \$26,320,910 in additional revenue in 1976 was required to produce the 8.7% overall rate of return which previously had been found by the commission to be just and reasonable.

On March 11, 1977, the district court entered judgment rejecting the commission's calculations. The district court ordered rates increased by the \$26,320,910 deficiency shown by the actual operating results to have existed in 1976.

Petitioner subsequently appealed to the Supreme Court of Louisiana on March 22, 1977, seeking an increase in the award of the district court to include a like attrition allowance for 1977, in addition to the attrition allowance approved for 1976. On April 21, 1977, the commission cross-appealed and prayed that the award of the district court be reduced or eliminated.

On November 3, 1977, the Supreme Court of Louisiana rendered its decision. The commission's order was reversed and the district court was affirmed insofar as it held that the commission erred in originally making no allowances for inflation and attrition. The Supreme Court held, however, in a 4 to 3 decision, that the district court erred in rejecting the commission's calculations of attrition on the ground that the district court had exceeded its authority in accepting and relying on petitioner's data. Appendix at 133a. Petitioner's arguments that due process of law was denied by the

(footnote continued from preceding page)

unit costs. As the rate base increases more rapidly than the resultant earnings, the rate of return decreases accordingly. To prevent this erosion in the actual rate of return earned by the utility, an erosion or attrition adjustment often is applied by the regulatory agency. See e.g., *New England Tel. & Tel. Co. v. Department of Pub. Util.*, 354 N.E.2d 860, 864-65 (Mass. 1976); *New England Tel. & Tel. Co. v. State*, 302 A.2d 814, 818 (N.H. 1973); *State v. New Jersey Bell Tel. Co.*, 152 A.2d 35, 46 (N.J. 1959). See generally, Nichols & Welch, *Ruling Principles of Utility Regulation*, 55 (Supp. A 1964).

commission in formulating its attrition calculations outside the record and contrary to actual operating results were not addressed by the Supreme Court of Louisiana.

The Supreme Court of Louisiana remanded the case to the commission to modify its order in accordance with its decision and to "proceed without taking further evidence to decide whether the Company is entitled to a rate increase, and to enter such order as justice may require." Appendix at 133a. The Supreme Court of Louisiana expressly retained jurisdiction over the case. The Court stated: "If the Company is dissatisfied with the Commission's decision, it may by motion filed in this Court within fifteen days following the Commission's action, bring the matter before us for further consideration." Appendix at 133a.

On November 16, 1977, petitioner applied for a rehearing and again raised the issue of the constitutionality of the procedure followed by the commission. Appendix at 107a. Petitioner expressly requested that the remand be broadened to require a hearing on the appropriateness of the commission's attrition calculations and consideration of actual earnings experienced since the end of the 1975 test year. Rehearing was denied December 14, 1977, without reasons. Appendix at 3a.

On December 30, 1977, petitioner filed a formal request with the commission to be heard and an affidavit by its Assistant Chief Accountant showing that in 1977, even with the full \$26,320,910 awarded by the district court, petitioner was unable to earn a rate of return even approaching the level found just and reasonable by the commission.

On January 25, 1978, the commission entered an order finding that no change should be made in the rate of attrition previously calculated but concluded that petitioner should have been permitted a revenue increase of \$11,356,000 - the

allowance for 1976 it had found earlier plus another adjustment for an error found by the court in a different area. Petitioner was ordered to file a new schedule of rates to produce the lower revenue award and to refund approximately \$15 million of the \$26,320,910 collected under the rates approved by the district court. Petitioner's request for a hearing on whether excessive revenues had been collected was denied as "beyond the scope of the remand." Appendix at 130a.

Pursuant to the order of the Supreme Court of Louisiana, petitioner filed on February 9, 1978 a "Motion for Further Consideration and Supplemental Brief." Appendix at 132a. Petitioner urged that the actions of the commission ordering refunds for a past period based on estimates contrary to actual operating results amounted to a denial of due process of law in violation of the 14th and 5th Amendments to the United States Constitution. This Court's opinion in *West Ohio Gas Co. v. Public Utilities Commission of Ohio* (No. 2), 294 U.S. 79 (1935), was cited as controlling precedent.

On February 24, 1978, the Supreme Court of Louisiana entered judgment denying petitioner's Motion for Further Consideration without reasons. Appendix at 1a.

REASON FOR GRANTING THE WRIT

THE REFUSAL OF THE LOUISIANA PUBLIC SERVICE COMMISSION TO CONSIDER ACTUAL 1976-1977 OPERATING RESULTS IN CALCULATING ATTRITION FOR THAT PERIOD CONFLICTS WITH ESTABLISHED PRECEDENT OF THIS COURT AND IS INCONSISTENT WITH OTHER STATE DECISIONS.

In *West Ohio Gas Co. v. Public Utilities Commission of Ohio* (No. 2), 294 U.S. 79 (1935), this Court established as a constitutional principle that it was a violation of due process standards for a regulatory agency in setting rates and ordering refunds to rely on mere estimates when actual results for the period in question were available. In *West Ohio Gas*, the state regulatory agency ordered refunds for two past years. The agency refused to consider actual operating results offered by the utility which showed that the utility's actual rates of return for those periods had been below the rate of return found by the agency to be just and reasonable. The Supreme Court of Ohio affirmed the agency's order. Following an appeal, this Court reversed. Writing for an unanimous Court, Justice Cardozo held that the agency's action violated due process:

"The earnings of the later years were exhibited in the record and told their own tale as to the possibilities of profit. To shut one's eyes to them altogether, to exclude them from the reckoning, is as much arbitrary action as to build a schedule upon guesswork with evidence available . . . [P]rophecy, however honest, is generally a poor substitute for experience. 'Estimates for tomorrow cannot ignore prices of today.' *Southwestern Bell Telephone Co. v. Public Serv. Commission of Missouri*, [262 U.S. 276, 288]. We have said of an attempt by a utility to give prophecy the first place and experience the second that 'elaborate calculations which are at war with realities are of no avail.' *Lindheimer v. Illinois Bell Telephone Co.*, 292 U.S. 151, 164. We say the same of a like attempt by officers of government prescribing rates to be effective in years when experience has spoken. A forecast gives us one rate. A survey gives another. To prefer the forecast to the survey is an arbitrary judgment." 294 U.S. at 81-82.

The present case is indistinguishable from *West Ohio Gas*. Here too, the commission ordered refunds based on "prophecy" and "forecasts", shutting its eyes to the "realities" of "experience". Here too, the actual "earnings [achieved in] the later years" were inadequate. By the test of *West Ohio Gas*, the action of the commission in ordering a refund was "arbitrary" and a violation of petitioner's constitutional rights.

The constitutional principle established in *West Ohio Gas* retains full vitality in the federal courts, *Williams v. Washington Metropolitan Area Transit Commission*, 415 F.2d 922, 945-46 (D.C. Cir. 1968), cert. denied sub nom. *D. C. Transit Sys., Inc. v. Williams*, 393 U.S. 1081 (1969); and *Summerfield v. CAB*, 207 F.2d 200, 204 (D.C. Cir. 1953), aff'd sub nom. *Western Air Lines, Inc. v. CAB*, 347 U.S. 67 (1954). Cf. *Algonquin LNG Inc. v. FERC*, ____ F.2d ___, Util.L.Rep. (CCH) ¶ 12050 (D.C. Cir. 1978), where, in remanding certain F.P.C. orders requiring refunds by a gas company the court of appeals commented:

"An aura of unreality surrounds the Commission's calculation of a new rate based on the sale of 600,000 barrels, when only 280,400 barrels were actually sold."

The *West Ohio Gas* principle has been adhered to in state proceedings as well. Most recently, the Supreme Court of Rhode Island considered whether the constitutional protections recognized in *West Ohio Gas* obligated the state regulatory agency to consider actual results in a remand proceeding. *New England Telephone & Telegraph Co. v. Public Utilities Commission*, 376 A.2d 1041 (R.I. 1977). In a thorough discussion of the issue, the Supreme Court of Rhode Island determined the extent to which the regulatory agency was required to consider actual results on remand.

"After the commission computes the test year rate base, revenues, expenses, and adjustments thereto for known future changes, and all the other factors which go into determining the allowed rate of return, the commission tries, in effect, to estimate how this allowed rate of return will be affected by future inflation. It then makes what it hopes will be an adequate erosion adjustment. Accordingly, if this forecast is challenged on appeal and the commission is instructed to correct it on remand, it seems appropriate and reasonable for the commission to compare its forecast with the company's actual subsequent results. It seems unreasonable for the commission on remand in 1976 to attempt to 'predict' what effect inflation will have in 1975 and 1976, based only on 1974 data, when the actual facts are known." 376 A.2d at 1047.

The Rhode Island Supreme Court held that the agency's refusal to consider updated information with respect to the attrition allowance would violate the constitutional principle established in *West Ohio Gas*.

"[T]here would then be an inadequate allowance for inflation, even though the issue was before the commission and the commission was perfectly capable of making an appropriate adjustment. This would be inconsistent with *West Ohio Gas Co.*" 376 A.2d at 1048.

The Court of Appeals of New York also recently required that state's regulatory agency to adhere, on remand, to the *West Ohio Gas* standard in determining whether the utility should be compelled to make refunds. *New York Telephone Co. v. Public Service Commission*, 272 N.E.2d 554, 556 (N.Y. 1971).

"The law is well-settled that the Commission may not rely on a reckoning when actual experience is available

and establishes that the predictions have been substantially incorrect. (*West Ohio Gas Co. v. Public Utilities Comm.* [No. 2], 294 U.S. 79, 82, 55 S.Ct. 324, 79 L.Ed.773) . . . This principle applies not only in cases where the rate proceeding fixes the rate but especially where the Commission directs refunds."

The Supreme Court of New Mexico in 1977 considered a similar issue and held that the state regulatory agency must receive updated evidence of the utility's operating results. *Mountain States Telephone & Telegraph Co. v. New Mexico State Corporation Commission*, 563 P.2d 588, 603 (N.M. 1977).

"Quite obviously the most recent figures would be the most reliable in determining adequate utility rates. This case has been in progress since April of 1975, a period of almost twenty-four months. It would be unreasonable to ignore the actual experience during that period of time in arriving at new rates.

"Common sense requires that the latest available economic information should be utilized in order to insure that the projected figures bear a meaningful relation to future as well as past and present fiscal realities. See *General Telephone Co. v. Michigan Public Serv. Com'n*, 341 Mich. 620, 67 N.W.2d 882 (1954); *Tampa Electric Co.*, 92 PUR3d 398 (Fla. Pub. Serv. Com'n. 1971)."

The Supreme Judicial Court of Massachusetts has also held that the Massachusetts' Department of Public Utilities must consider evidence of attrition which has actually occurred since the test period. *Boston Gas Co. v. Department of Public Utilities*, 269 N.E.2d 248, 257-59 (Mass. 1971). The Supreme Court of Alabama recently remanded a rate of return determination to the Alabama Public Service Commission "to test those returns by a

practical yardstick — the actual experience under the order." *General Telephone Co. of Southeast v. Alabama Public Service Commission*, 335 So.2d 151, 159 (Ala. 1976). See also *New England Telephone & Telegraph Co. v. Department of Public Utilities*, 354 N.E.2d 860 (Mass. 1976); *New England Telephone & Telegraph Co. v. State*, 302 A.2d 814 (N.H. 1973); *Southern New England Telephone Company v. Public Utilities Commission*, 282 A.2d 915 (Conn. 1970); *Letourneau v. Citizens Utilities Co.*, 259 A.2d 21 (Vt. 1969).

The rationale of these cases is not new. The guiding constitutional principle was established by this Court over forty years ago. Most state regulatory agencies have followed the principle of *West Ohio Gas*. Where regulatory agencies have deviated, the state courts have reversed, reaffirming the constitutional standard.² As noted by the Supreme Court of Rhode Island:

"[T]his issue has only recently grown to be a significant problem. . ." *New England Tel. & Tel. Co. v. Public Util. Comm'n.*, 376 A.2d at 1046.

²But see, *Mountain States Tel. & Tel. Co. v. Public Util. Com'n.*, 502 P.2d 945 (Colo. 1972), where the Supreme Court of Colorado attempted to distinguish *West Ohio Gas* as being "a ratemaking case, not a refund case." 502 P.2d at 948. The distinction is incorrect. It is, in any event, a "distinction without a difference." H. Fielding, *Tom Jones*, book VI, ch. 13 (1749). Of course, the present case was not only a refund case but was, in fact, a ratemaking case as well in that the Supreme Court of Louisiana specifically directed the commission to fix rates in conformity with its order of November 3, 1977.

Mountain States demonstrates the growing confusion and developing conflict over application of *West Ohio Gas*. Compare *New York Tel. Co. v. Public Serv. Comm'n.*, *supra*; *New England Tel. & Tel. Co. v. Public Util. Comm'n.*, 376 A.2d 1041 (R.I. 1977).

In the present case, the Louisiana Public Service Commission has ordered petitioner to refund revenues that will reduce petitioner's actual earnings below a level the Commission itself found to be just and reasonable. The Commission based its order on an estimated attrition allowance for 1976-77 that actual results have shown to be incorrect. In refusing on two occasions to consider the actual operating results for this period, the Commission deviated from established standards of due process. The injurious effect to petitioner is immediate³ and substantial. The commission's order requires petitioner to refund \$15 million for a period in which petitioner was not able to earn the authorized rate of return even with the total rate increase approved by the lower court of \$26,320,910 in effect. To require this refund further depresses an already inadequate earnings level and amounts to confiscation of petitioner's property in violation of the 14th and 5th Amendments of the Constitution of the United States.

The decision of the Supreme Court of Louisiana in affirming the Commission's action conflicts with *West Ohio Gas* and is inconsistent with decisions of the highest courts of other states. If this decision is allowed to stand it will deny petitioner the due process protections found to be guaranteed by the 14th and 5th Amendments and will undermine established precedent consistently applied by other states. The problem of conflicting standards is, of course, highly significant in view of the substantial number and recurring nature of utility rate proceedings throughout the country.

³Where there is a present confiscation, it is no answer to suggest, as does the commission, that the solution lies in a new rate proceeding. "Present confiscation is not atoned for by merely holding out the hope of a better life to come." *West Ohio Gas Co. v. Public Util. Comm'n* (No. 2), 294 U.S. 79, 82 (1935). See also *New York Tel. Co. v. Public Serv. Comm'n.*, 272 N.E.2d 554, 557 (N.Y. 1971).

CONCLUSION

Accordingly, the Court should grant certiorari in order to reaffirm the principle of *West Ohio Gas*, eliminate developing conflicts among state jurisdictions and protect petitioner from confiscation of its property.

Respectfully submitted,

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